

Fixed-Asset Loans for Small Businesses

The 504 Loan Program

The U.S. Small Business Administration's 504 Loan Program, also known as the Certified Development Company Program, provides affordable long-term, fixed-rate financing to help healthy, expanding small businesses grow. The loans are for acquiring long-term fixed assets, such as land, buildings, machinery and equipment, or for building, modernizing, renovating or restoring facilities.

Why a 504 Loan?

Growing businesses have big plans, big ideas and big needs. Often, however, they are unable to qualify for traditional financing because of the difficulty of coming up with down payments of 30 percent or more. When a conventional loan is not possible, a 504 loan may be the answer. The SBA's 504 Loan Program gives small business owners access to the same low-cost, fixed-rate, long-term financing large businesses have through bond markets. Other borrower advantages include:

- generally a lower down payment;
- below-market, fixed-rate financing, which avoids the uncertainties of future market fluctuations; and
- a longer repayment term that brings debt service in line with the cash flow generated by the asset.

What Are 504 Certified Development Companies?

CDCs are nonprofit organizations, often sponsored by state and local governments, established to promote economic development in their communities. Certified by the SBA, CDCs operate under the jurisdiction of a board that includes local government officials, private-sector lending institutions, and business and community organizations. There are approximately 270 CDCs nationwide.

CDCs help small businesses with financing for fixed-asset projects by assembling, analyzing and making recommendations on loan packages, submitting their analyses and recommendations to the SBA for approval, and closing and servicing the 504 loans.

Typically a 504 loan project includes -

- a loan secured with a senior lien from a private-sector lender (covering a percentage of the total cost);
- a loan secured with a junior lien from a CDC (a 100 percent SBA-guaranteed debenture), covering up to 40 percent of the total cost; and
- a contribution of at least 10 percent equity from the borrower.

The borrower's minimum equity injection of 10 percent is increased by 5 percent if the borrower's business is new or if the financing is for a limited-use asset. If both factors apply, the combined increase is 10 percent.

The 504 Loan Program provides permanent take-out financing for long-term assets. Interim financing is usually required between the start of the project - which may include construction after the SBA loan is approved - and receipt of funding from 504 debentures and other permanent financing. (The debenture will not actually be funded until the project is completed.)

Amount of the Loan

A CDC-financed project can be any size, but the SBA-backed portion normally is limited to 40 percent of a project or \$750,000 (up to \$1 million in some cases), whichever is less. The minimum debenture is \$50,000. Typical projects range in size from \$500,000 to \$1.5 million. For every \$35,000 of debenture financing in the CDC's portfolio, the SBA requires that an average of one job be created or retained within two years of the project's funding.

Sample 504 Project

	Private Lender	504 Financing	Borrower's	Equity
% of project	50%	40%		10%
Security		1 st lien	2 nd lien	
\$ amount		no limit	\$50,000 - \$1 mil.	
Interest rate	variable or fixed	fixed		
Real estate terms	10+ years	20 years		
Equipment terms	7 years	10 years		

Use of Proceeds

Loan proceeds generally may be used for the following fixed-assets:

- Purchasing land and existing buildings, and making improvements such as grading, utilities, parking lots and landscaping;
- Constructing, modernizing, renovating or converting existing facilities; and
- Purchasing machinery and equipment that have a useful life of 10 years or more.

Terms

Interest rates on 504 loans are fixed at the time of the debenture sale. Interest rates approximate the current market rate for five- and 10-year U.S. Treasury issues, plus a small increment. Maturities of 10 and 20 years are available. Repayment is made in monthly installments.

Collateral usually includes a mortgage on the land and buildings being financed; liens on machinery, equipment and fixtures; and lease assignments, as well as other assets. The private-sector lender does not receive an SBA guaranty but is usually secured by a first lien on the project. The SBA is secured by a second lien and, if needed, additional collateral. The agency also requires personal guaranties from individuals who own 20 percent or more of the business.

Fees

Fees total approximately 3 percent of the debenture and may be financed with the loan. These include a CDC processing fee of 1.5 percent, a guaranty fee, a funding fee and an underwriting fee.

Eligibility

To be eligible, a business must be a for-profit corporation, limited liability company, partnership or proprietorship with a net worth (including any affiliates) of \$6 million or less. Average net profits after taxes cannot exceed \$2 million per year for the previous two years.

Bottom-Line Benefits for Commercial Lenders

There are many incentives for lenders to use the SBA's 504 Program. Lenders can -

- reduce risk by financing a smaller portion of the project while maintaining a first-lien position on 100 percent of the assets being financed.
- retain commercial-account relationships while participating in the long-term financing.
- make bigger loans; total financing can be \$2.5 million or more.
- sell their first-mortgage portion in the secondary market.
- comply with the Community Reinvestment Act and extend legal lending limits.
- generate new business for years to come.
- broaden the community's tax base.
- stimulate the local economy through job creation and retention.
- save time, since there's no SBA paperwork for the lender.

For More Information

- SBA offices are located in all 50 states, the District of Columbia, Puerto Rico, the U.S. Virgin Islands and Guam. For the office nearest you, look under "U.S. Government" in your telephone directory, or contact:
- Phone: 1-800 U ASK SBA
- Fax: 202-205-7064
- E-mail: answerdesk@sba.gov
- TDD: 704-344-6640
- OnLine Electronic Bulletin Board (modem and computer required)
 - 1-800-697-4636 (limited access)
 - 1-900-463-4636 (full access)
 - 202-401-9600 (Washington, D.C., metro area)
- Internet
 - Home page: www.sba.gov
 - Gopher: <gopher.sba.gov>
 - Telnet: <telnet.sba.gov>
 - U.S. Business Advisor: www.business.gov
- Your rights to regulatory fairness: 1-888-REG-FAIR

SBA Partners

Inquire at your local SBA office for the location nearest you.

- BICs - Business Information Centers
- TBICs - Tribal Business Information Centers
- OSCSs - One Stop Capital Shops
- SCORE - Service Corps of Retired Executives
- SBDCs - Small Business Development Centers
- USEACs - U.S. Export Assistance Centers
- WBCs - Women's Business Centers

SBA Publications

- The Facts About ... SBA Publications - a listing of free SBA publications

Did you know that in fiscal 1999 the SBA -

- maintained a guaranteed loan portfolio of more than \$40.5 billion in loans to 486,000 small businesses that otherwise would not have had such access to capital?
- backed nearly 49,000 loans totaling a record \$12.5 billion to America's small businesses?
- made 3,100 investments worth \$4.2 billion through its venture capital program?
- provided more than 36,000 loans totaling over \$936 million to disaster victims for residential, personal-property and business losses?
- extended management and technical assistance to more than 900,000 small business persons through its 11,500 Service Corps of
- Retired Executives volunteers and 1,000 small business development center locations?
- created HUBZones providing federal contracting assistance to small businesses located in "historically underutilized business zones"?

Did you know that since 1987 the SBA's 504 Loan Program has -

- approved more than 40,000 loans?
- provided more than \$13.5 billion in guaranteed debentures?
- assisted in the creation of more than one million jobs?

Did you know that America's 24 million small businesses -

- employ more than 52 percent of the private work force?
- generate more than 51 percent of the nation's gross domestic product?
- are the principal source of new jobs?

All of the SBA's programs and services are provided to the public on a nondiscriminatory basis.

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